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# In the Supreme Court of the United States

OCTOBER TERM, 1953

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No. 314

CHARLES R. WHITWORTH AND ESTATE OF SARAH M. WHITWORTH, CHARLES R. WHITWORTH, EXECUTOR, PETITIONERS

*v.*

COMMISSIONER OF INTERNAL REVENUE

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT*

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## BRIEF FOR THE RESPONDENT IN OPPOSITION

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### OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 121-133) are not officially reported. The opinion of the Court of Appeals (R. 140-146) is reported at 204 F. 2d 779.

### JURISDICTION

The judgment of the Court of Appeals was entered on June 12, 1953. (R. 147.) The petition for a writ of certiorari was filed on September 4, 1953.

The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

## QUESTION PRESENTED

The taxpayer, a former member of a partnership engaged in the business of public accounting, retired from the firm pursuant to an agreement which entitled him to certain payments for a period of five years out of the profits, if any, of the continuing partnership.

The question is whether these payments are taxable as ordinary income, as the Tax Court and the Court of Appeals held, or are taxable as capital gain, as the taxpayer contends.

## STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * * *
>
> (26 U.S.C. 22.)

STATEMENT

The material facts, as found by the Tax Court, may be summarized as follows:

The taxpayer became a partner in 1919 in the firm of Touche, Niven & Company. The firm was engaged in the business of acting as public accountants and auditors. The taxpayer made a capital contribution of $12,500 at the time he became a partner. (R. 122.)

A new partnership agreement was signed in 1936 by seventeen partners. Of these, five were designated as administrative partners who were to manage and control the business and affairs of the partnership. The taxpayer was one of the administrative partners. (R. 122.)

The partnership agreement (Ex. B-2, R. 36-62) provided in Article IV (R. 40, 123), that the firm name of Touche, Niven & Company should belong to the firm and should not be disposed of so long as the partnership continued its existence; it also provided that a deceased, retiring or withdrawing partner "shall have no interest in the firm name and shall have no right to receive any payment therefor." The death, retirement or withdrawal of any partner was not to dissolve the partnership between the remaining partners and the interest of such deceased, retiring or withdrawing partner in the firm's assets and business was to become vested in the continuing partners; the deceased, retiring or withdrawing partner was to have no further interest in the firm's assets or business, except the right to receive certain payments provided for in Article

XI of the partnership agreement. (Art. X, Secs. 1 and 6, R. 45-47, 124-125.)

A retiring or withdrawing partner, or the estate of a deceased partner, was entitled to receive immediately any loan made by the partner to the firm and any balance in his current account adjusted to the time of his death, withdrawal or retirement. (Art. XI, Sec. 1 (a), R. 47, 125-126.) He was also entitled to receive his portion of the distributable profits from the beginning of the current fiscal year to the date of death, retirement or withdrawal. This amount was payable during the ensuing fiscal year. (Art. XI, Sec. 1 (b), R. 47, 126.) He was also entitled to receive a return of his paid-up participation in the stated capital of the firm, this sum being payable in six semi-annual installments, with the unpaid balance bearing interest at the rate of five percent per year. (Art. XI, Sec. 1 (c), R. 47-48, 126.)

Article XI, Section 2, provided for additional payments in the case of a partner who retired from the firm after reaching the age of 65 or who died at any age. These payments, which were to be made out of the "distributable profits" of the firm, were to be in such amounts as might be determined by the administrative partners, but not less than the smaller of the following amounts (Art. XI, Sec. 2, R. 48-49):

> (a) an amount equal to the sum of the salary plus the distributable profits of the partnership which such deceased or retiring partner received or was entitled to receive in respect

of the business of the partnership carried on during the three (3) fiscal years of the partnership next preceding the fiscal year in which such partner died or retired; or

(b) an amount equal to the sum of the salary plus the distributable profits of the partnership to which such deceased or retiring partner would have been entitled, if he had not died or retired and if his ratio in the profits of the partnership had not been altered, in respect of the business of the partnership carried on during the three (3) succeeding fiscal years of the partnership, including the fiscal year in which such partner died or retired, but for the purposes of this subdivision (b) the distributable profits shall be determined after deducting current salaries and current interest on capital of any additional partners as well as those of the surviving or continuing partners.

The amount was to be paid in six equal, annual installments and, unless there were not sufficient profits of the continuing firm, the annual installments were not to be less than fifty percent of the annual salary of the former partner or less than $5,000 per year. (R. 49, 127.)

Article XI, Section 2, specifically provided that (R. 49, 127):

> The payment under this Section 2 is intended as a distribution of income to the retiring partner or the estate of a deceased partner for a limited period subsequent to his retirement or death.

Article XI, Section 3 (R. 50, 128), provided that a majority in interest of the administrative partners could pay such sum of money in such installments as they might deem advisable to any partner who retired before reaching the age of 65 or who withdrew for any other reason.

The taxpayer wrote a letter (Ex. C-3, R. 63-64, 128-129) to the firm in October, 1939, reiterating his previously expressed desire to retire from the partnership when he reached the age of 60, on October 12, 1943, and stating his understanding that it was agreeable to the firm that, even though he would retire prior to reaching 65, nevertheless (R. 129): "the provisions of Section 2 of Article XI of the partnership agreement shall be applicable * * *." He requested that the firm note its acceptance of his letter as an agreement that, among other things (R. 129) "the provisions of Section 2 of Article XI shall be applicable to my retirement" and that the payments under Section 2 of Article XI should be accelerated so as to be made in five rather than six years. The firm noted acceptance of the terms of the letter.

Pursuant to this agreement, the taxpayer retired from the partnership on April 30, 1942, to accept a commission with the United States Army. He was then 59 years of age. On November 27, 1942, the firm wrote to the taxpayer (Ex. E-5, R. 66-68, 130-131) "to incorporate our agreement in a letter signed by the firm and approved by you." The letter stated that for the fiscal years ending on September 30, 1942, and September 30, 1943, the tax-

payer was to receive an amount equal to his salary and interest in the distributable profits of the firm "the same as though you had remained a member of the firm," except that, as they had agreed, the average for the four years ending September 30, 1943, should not exceed $20,000 per year. The letter also stated (R. 67, 130-131):

> 2. Notwithstanding the fact that you have not and will not have attained the age of sixty-five years on September 30, 1943, you shall be entitled to receive the retirement payments provided for in Section 2 of Article XI of the Partnership Agreement which shall be computed and be payable as if you had retired on September 30, 1943 except that, upon your request, we will accelerate the payments provided under Section 2 of Article XI so that the said payments shall be made in five instead of six years.
>
> 3. You shall be entitled to receive the payments provided for in Section 1 of Article XI of the Partnership Agreement but, notwithstanding your retirement as of May 1, 1942, said payments shall be determined and be payable as if you had retired on September 30, 1943.

The taxpayer signified his approval of this arrangement by an endorsement of the letter. (R. 68, 131.) Pursuant to the agreement, the taxpayer received $20,405.17 in 1942, and $20,000 in 1943, as his salary and share of distributable profits. He also received $12,500 on account of the credit balance in his capital account and $3,978.36 as his

share of the cash surrender value of a life insurance policy on the life of John B. Niven, the premiums on which had been charged to all the partners. In addition, the taxpayer received $12,000 in each of the years 1944-1948, inclusive, pursuant to the agreement under which he had retired from the firm. (R. 131.)

The Tax Court held that the $12,000 payments received by the taxpayer in each of the taxable years 1945 and 1947 constituted ordinary income and were not, contrary to taxpayer, taxable as capital gain from the sale of his partnership interest. (R. 133.) The Court of Appeals affirmed. (R. 140-146.)

ARGUMENT

1. The taxpayer, upon retirement as a partner from a large accounting firm, was repaid his original capital contribution. In addition, by agreement, as a retired partner he became entitled to receive certain payments from the partnership during a five year period. The amount of the retirement payments was determined by the extent to which he had been entitled to participate in the firm's profits during the three year period preceding his retirement and they were to be made only out of the profits of the firm, if any. The Tax Court and the Court of Appeals held that these retirement payments, totaling $60,000 during the five year period, were taxable as ordinary income and rejected the taxpayer's contention that the payments represent the proceeds from the sale of his partnership

interest and that they were taxable as capital gain. The decisions of the courts below are demonstrably correct.

Under the express terms of the partnership agreement, the taxpayer, upon withdrawing from the firm, was entitled to the return of his capital investment, and to receive his share of current profits up to the date of retirement, and to nothing else. He had, as a party to the articles of partnership, agreed in advance that the partnership would not be dissolved on his retirement, that the firm name would belong to the continuing partners, and that they should be entitled to retain all the firm's assets and would be empowered to continue the firm's business. He had agreed that, if he should retire, he would possess no further interest in the assets or business of the firm and would only be entitled to the particular payments specified in the agreement. (Ex. B-2, Arts. IV and X, R. 40, 45-47.) And, since the taxpayer chose to retire prior to reaching the age of 65, he was, except for the repayment of his capital investment and for the payment of his share of current earnings (Ex. B-2, Art. XI, Sec. 1, R. 47-48), entitled to receive nothing from the continuing partners under the precise terms of the partnership agreement. Since the taxpayer had nothing of value to sell, the subsequent agreement permitting him to receive retirement payments (notwithstanding that he was not entitled to those payments under the precise terms of the partnership agreement) did not and could not represent a sale of a capital asset

to the continuing partners. *Bull* v. *United States*, 295 U.S. 247, 254. The Court of Appeals, accordingly, correctly concluded that (R. 146):

> The fact that taxpayer received from the firm more than he had a right to demand is no indication that the sums received were in payment for any interest in the firm or that they became upon receipt an enhancement in his capital assets as distinguished from income. * * *

The taxpayer's argument (Pet. 13-17) that the payments were made to acquire his interest in the firm necessarily ignores the terms of the partnership agreement which, as has been shown, demonstrates that a withdrawing or retiring partner had no interest beyond his capital contribution. It also ignores the testimony of all the witnesses which was to the effect that the retirement payments under the partnership agreement were not intended as the purchase price of the withdrawing partner's interest. (R. 74-76, 78, 79, 106, 109-110, 112-113.) There is no contrary evidence. The taxpayer's suggestion that, unless a partnership interest were sold, there would have been no consideration for the payments to him (Pet. 15-17) may prove that the partnership was under no obligation to make the payments, but it does not at all establish that the payments which he did in fact receive were the proceeds from the sale of a capital asset taxable at preferential rates under Code Section 117.[1]

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[1] While the factual situation necessarily varies from case to case, the decision in the present case is in harmony with

2. The taxpayer also contends that the payments are not taxable at all because they constituted gifts which are exempt from tax under Code Section 22 (b)(3). (Pet. 8-13.) This argument is a distinct afterthought for no such claim for exemption was made in the court below or even alluded to in the three separate briefs filed by the taxpayer, nor was such an argument made in the Tax Court. On the contrary, until the filing of the petition for a writ of certiorari, the taxpayer's position has always been that the income in question was capital gain because it had been received as consideration for the sale of his partnership interest, a position completely inconsistent with the notion that a gift was received. Plainly, the contention that a gift was received cannot be raised for the first time in this Court. *Helvering* v. *Minnesota Tea Co.*, 296 U.S. 378, 380; *Helvering v. Tex-Penn Oil Co.*, 300 U.S. 481, 498; *General Utilities Co.* v. *Helvering*, 296 U.S. 200, 206.

At all events, the argument is devoid of merit for

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numerous Tax Court decisions. See *Collins* v. *Commissioner*, 14 T.C. 301; *Hess* v. *Commissioner*, 12 T.C. 773; *McAfee* v. *Commissioner*, 9 T.C. 720; *Remington* v. *Commissioner*, 9 T.C. 99; *Coates* v. *Commissioner*, 7 T.C. 125; *Hallowell* v. *Commissioner*, 39 B.T.A. 50; *Proctor* v. *Commissioner*, 39 B.T.A. 67; *Barth* v. *Commissioner*, 35 B.T.A. 546; *Gudeon* v. *Commissioner*, 32 B.T.A. 100; *Smith* v. *Commissioner*, decided November 29, 1950 (1950 P-H T.C. Memorandum Decisions, par. 50,286); *Madden* v. *Commissioner*, decided July 2, 1946 (1946 P-H T.C. Memorandum Decisions, par. 46,158). See also *Wilkins* v. *Commissioner*, 161 F. 2d 830 (C.A. 1st), affirming 7 T.C. 519; *Edwards* v. *Commissioner*, 102 F. 2d 757 (C.A. 10th); *Krusen* v. *Commissioner*, 148 F. 2d 210 (C.A. 3d), affirming *per curiam* the decision of the Tax Court dated August 31, 1944 (1944 P-H T.C. Memorandum Decisions, par. 44,287).

there is nothing in the record which would have supported a finding that a gift was intended, even if such a contention had been seasonably advanced in the Tax Court. The record evidence shows that the retirement payments provided for in the partnership agreement constituted a business arrangement, carefully planned by all the partners, and were intended to soften the economic hardship that might otherwise attend a partner's retirement. Nor is there any evidence to demonstrate that the provision for these similar payments to the taxpayer arose out of any different motives. In short, in this arms' length business transaction there is completely absent the donative intent which is the prerequisite of a tax exempt gift of property. *Robertson* v. *United States,* 343 U.S. 711, 713-714; *Commissioner* v. *Jacobson,* 336 U.S. 28, 51. The fact that the payments were gratuitous, in the sense that the partnership was under no legal obligation to undertake them, is quite immaterial for the same is true, for example, where a bonus or additional compensation is voluntarily paid; such payments constitute taxable income coming within the broad sweep of Code Section 22 (a), *supra,* and are not gifts. *Old Colony Tr. Co.* v. *Commissioner,* 279 U.S. 716, 731; *Noel* v. *Parrott,* 15 F. 2d 669 (C.A. 4th), certiorari denied, 273 U.S. 754.

3. Notwithstanding the taxpayer's sweeping assertion that the decision below conflicts with applicable decisions of this Court (Pet. 8), it is plain that no such conflict exists. The cases on which the taxpayer apparently relies (Pet. 8) all involve the

question whether, in a gratuitous, intra-family disposition, taxable income can be deflected from the person who earns it. These decisions have nothing to do with the issue whether taxable income is realized by the recipient of payments flowing out of an arms' length business transaction, nor do they have the slightest bearing on whether capital gain or ordinary income is realized in the circumstances here or in any other circumstances.

### CONCLUSION

There is no conflict in decisions. The decision of the Court of Appeals is correct. There is no reason which would warrant further review of this case. Accordingly, the petition for a writ of certiorari should be denied.

Respectfully,

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SEPTEMBER, 1953.

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